

Internal Revenue Service

Number: **200739006**

Release Date: 9/28/2007

Index Number: 1362.04-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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CC:PSI:B02

PLR-153645-06

Date:

June 21, 2007

X =

A =

GRAT
1 =

GRAT
2 =

Trust 1 =

Trust 2 =

D1 =

D2 =

D3 =

D4 =

Dear :

This responds to a letter dated November 9, 2006, and subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated on D1 and elected to be an S corporation effective D1. On D2, all of the issued and outstanding shares of X were held by individuals and two trusts, GRAT 1 and GRAT 2 ("GRATs"), treated as grantor retained annuity trusts. The GRATs were treated as grantor trusts under subpart E of part I of subchapter J of chapter 1 of the Code. On D3, the GRATs ceased to be grantor trusts and Trust 1 and Trust 2 were established as successor trusts. On D3 and thereafter, Trust 1 and Trust 2 each satisfied all of the requirements of a qualified subchapter S trust ("QSST") within the meaning of § 1361(d)(3). However, A, the income beneficiary of Trust 1 and Trust 2 failed to timely file an election under § 1361(d)(2)(A). Accordingly, X's S corporation election was terminated on D3. On D4, X's accountant discovered the failure of Trust 1 and Trust 2's beneficiary to file the respective QSST elections and notified X that X's S election had terminated. X and X's shareholders represent that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X and each person who was or is a shareholder of X at any time since D3 agree to make such adjustment (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period.

Section 1361(b)(1)(B) provides that a "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that for purposes of section 1361(b)(1)(B), a trust may be a shareholder if all of it is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States. Section 1361(c)(2)(B)(i) provides that for purposes of section 1361(b)(1), in the case of a trust described in section 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

Section 1361(d)(1) provides that in the case of a qualified subchapter S trust (QSST) with respect to which a beneficiary makes an election under section 1361(d)(2), such trust shall be treated as a trust described in section 1361(c)(2)(A)(i) and, for purposes of section 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under section 1361(d)(2) is made.

Section 1362(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative)

may elect to have section 1361(d) apply. Section 1361(d)(2)(D) provides that an election under section 1362(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) provides that the term "qualified subchapter S trust" means a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and (iv) upon termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and (B) all of the income (within the meaning of section 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

Section 1.1361-1(j)(6)(iii) of the Income Tax Regulations provides that if S corporation stock is transferred to a trust, the QSST election must be made within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust.

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under § 1362(d)(2) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in the termination, steps were taken so that the corporation is a small business corporation; and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified under § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary for that period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts submitted and the representations made, we hold that X's election to be an S corporation terminated on D3, as a result of the failure of the beneficiary of Trust 1 and Trust 2 to make the election required under § 1361(d)(3)(A). We also hold that the termination was inadvertent within the meaning of § 1362(f).

We further hold that, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from D3 and thereafter provided that the required QSST elections for Trust 1 and Trust 2, with an effective date of D3, are filed with the appropriate service center within 60 days from the date of this letter, and X's election to be an S corporation was otherwise valid and was not otherwise terminated under § 1362(d). From D3 and thereafter, Trust 1 and Trust 2 (as QSSTs with A as the beneficiary) shall be treated as owning the X stock. Accordingly, the shareholders of X must include in income their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat X as described above, this letter ruling will be null and void. Therefore, Trust 1, Trust 2 and A will have to file amended returns to reflect the conclusions of this ruling.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether X was or is a small business corporation under § 1361(b), or whether Trust 1 or Trust 2 are QSSTs within the meaning of § 1361(d)(3).

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

J. Thomas Hines
Chief, Branch 2
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes